

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

ELIMINATING ENTRIES

Report No. 97-117

March 31, 1997

19991026 056

Department of Defense

DTIC QUALITY INSPECTED 4

DISTRIBUTION STATEMENT A
Approved for Public Release
Distribution Unlimited

AOI 00-01-0169

Additional Copies

To obtain additional copies of this audit report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

Defense Hotline

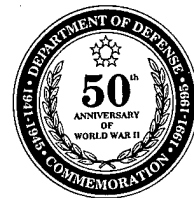
To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by e-mailing Hotline@DODIG.OSD.MIL; or by writing to the Defense Hotline, The Pentagon, Washington, DC 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
OMB	Office of Management and Budget



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884



March 31, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
COMMANDER, U.S. ARMY CORPS OF ENGINEERS

SUBJECT: Audit Report on Eliminating Entries (Report No. 97-117)

We are providing this audit report for review and comments. We performed the audit of eliminating entries as part of the audit of the FY 1996 DoD-wide Consolidated Financial Statements. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. As a result of management comments, we revised and redirected Recommendation 2. to the Under Secretary of Defense (Comptroller). Therefore, we request that the Under Secretary of Defense (Comptroller) comment on Recommendation 2. in response to the final report. We request that management provide comments by May 30, 1997.

We appreciate the courtesies extended to the audit staff. If you have any questions, please contact Mr. F. Jay Lane, Acting Director, at (703) 604-9101 (DSN 664-9101) or Mrs. Sandra G. Elion, Audit Project Manager, at (703) 604-9113 (DSN 664-9113). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-117
(Project No. 5FH-2026)

March 31, 1997

Eliminating Entries

Executive Summary

Introduction. The Federal Financial Management Act of 1994, which amended the Chief Financial Officers Act of 1990, requires DoD and 23 other agencies to prepare agency-wide audited financial statements beginning in FY 1996. The 1994 act also requires the Department of the Treasury to prepare Government-wide audited financial statements starting in FY 1997. To comply with the law, DoD has prepared financial statements for the eight reporting entities* to be included in the FY 1996 DoD-wide Consolidated Financial Statements. The entities' assets reported by DoD in FY 1995, excluding Other Defense Organizations, totaled \$1,306 billion, and revenues totaled \$303 billion. When an entity prepares consolidated financial statements, it should eliminate the effects of financial transactions among its components and should report only transactions with outside parties. This audit report is the first in a series of reports on the FY 1996 DoD-wide Consolidated Financial Statements.

Audit Objective. We determined whether eliminating entries were properly reported on the FY 1995 financial statements of the eight entities to be included in the FY 1996 DoD-wide Consolidated Financial Statements. The overall audit objective was to determine whether the FY 1996 DoD-wide Consolidated Financial Statements are presented fairly in accordance with the other comprehensive basis of accounting described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements." The overall objective will be discussed in subsequent reports after the FY 1996 financial statements are prepared.

Audit Results. Eliminating entries generally were not reported or were not properly reported on the FY 1995 financial statements of the entities to be included in the FY 1996 DoD-wide Consolidated Financial Statements. Unreported interdepartmental transactions (between DoD Components) were calculated at \$74.5 billion in revenues, \$75.6 billion in collections, and \$10.2 billion in accounts receivable. In prior audit reports, we identified similar conditions in the Defense Business Operations Fund for

*The reporting entities include the Departments of the Army, Navy, and Air Force; the Defense Business Operations Fund; the U.S. Army Corps of Engineers (Civil Works); the DoD Military Retirement Trust Fund; the National Defense Stockpile Transaction Fund; and Other Defense Organizations.

FYs 1992 through 1995 (see Appendix B). If such transactions are not reported and eliminated, DoD-wide and Government-wide consolidated financial statements will be materially overstated.

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service, establish requirements for new and interim migratory accounting systems that will identify sellers and purchasers in reimbursable transactions, and develop procedures to extract reimbursable transactions from databases that support the "Report on Reimbursements" and report these transactions in Note 29, "Intrafund Eliminations." We also recommend that the Under Secretary of Defense (Comptroller) issue policy that requires sellers and purchasers in reimbursable transactions be identified, and that selling DoD Components be required to report annual sales to purchasing DoD Components. We also recommend that the Commander, U.S. Army Corps of Engineers, establish procedures for identifying transactions with other Federal agencies and report this information in Note 29.

Management Comments. The Defense Finance and Accounting Service concurred with the recommendations to establish requirements for new and interim migratory accounting systems and develop procedures to extract reimbursable transactions from databases that support the "Report on Reimbursements." The U.S. Army Corps of Engineers concurred with the recommendation to establish procedures for identifying transactions with other Federal agencies. The Defense Finance and Accounting Service nonconcurred with the recommendation to require the reporting of total annual sales by DoD Components, pointing out that no Office of Management and Budget or Under Secretary of Defense (Comptroller) guidance requires the additional reporting. See Part I for a summary of management comments and Part III for the complete text of those comments.

Audit Response. Management comments were responsive to the recommendations to establish requirements for new and interim migratory accounting systems, develop procedures to extract reimbursable transactions from databases that support the "Report on Reimbursements," and establish procedures for identifying transactions with other Federal agencies. As a result of management comments on the recommendation regarding the reporting of total annual sales by DoD Components, we revised and redirected the recommendation to the Under Secretary of Defense (Comptroller). We request comments from the Under Secretary of Defense (Comptroller) by May 30, 1997.

Table of Contents

Executive Summary	i
Part I - Audit Results	
Audit Background	2
Audit Objective	3
Reporting of Eliminating Entries	4
Part II - Additional Information	
Appendix A. Audit Process	
Scope and Methodology	16
Management Control Program	16
Organizations and Individuals Visited or Contacted	17
Appendix B. Prior Audits and Other Reviews	18
Appendix C. Report Distribution	21
Part III - Management Comments	
Defense Finance and Accounting Service Comments	24
U.S. Army Corps of Engineers Comments	28

Part I - Audit Results

Audit Background

The Federal Financial Management Act of 1994, which amended the Chief Financial Officers Act of 1990, requires DoD and 23 other agencies to prepare agency-wide audited financial statements beginning in FY 1996. The 1994 act also requires the Department of the Treasury to prepare Government-wide audited financial statements starting in FY 1997. To comply with the law, the Under Secretary of Defense (Comptroller), in coordination with the Office of Management and Budget (OMB), directed DoD to prepare financial statements for eight entities to be included in the FY 1996 DoD-wide Consolidated Financial Statements. The eight entities are the Departments of the Army, Navy, and Air Force; the Defense Business Operations Fund (DBOF); the U.S. Army Corps of Engineers (Civil Works) (the Corps of Engineers); the DoD Military Retirement Trust Fund; the National Defense Stockpile Transaction Fund; and Other Defense Organizations. The entities' assets reported by DoD in FY 1995, excluding Other Defense Organizations, totaled \$1,306 billion, and revenues totaled \$303 billion. The entities will prepare principal statements and related notes that consist of:

- o a statement of financial position, showing assets, liabilities, and net position;
- o a statement of operations and changes in net position, showing the results of operations for the reporting period, including the changes in net position from the end of the prior reporting period; and
- o a statement of cash flows, showing gross cash receipts and cash payments with an explanation of the changes for the reporting period (required only for revolving funds such as DBOF).

When an entity prepares consolidated financial statements, it should eliminate the effects of financial transactions among its components. In financial statements for the consolidated entity, the revenues, expenses, assets, and liabilities should be reported based on transactions with outside parties. The issue of eliminating entries was identified during our audit of the FY 1996 DoD-wide Consolidated Financial Statements and in prior audit reports on DBOF for FYs 1992 through 1995 (see Appendix B).

Audit Objective

We determined whether eliminating entries were properly reported on the FY 1995 financial statements of the entities to be included in the FY 1996 DoD-wide Consolidated Financial Statements. The overall audit objective was to determine whether the FY 1996 DoD-wide Consolidated Financial Statements are presented fairly in accordance with the other comprehensive basis of accounting described in OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993.¹ The overall objective will be discussed in subsequent reports after the FY 1996 financial statements are prepared. See Appendix A for details on the audit scope and methodology and Appendix B for prior audit coverage of eliminating entries.

¹As part of the other comprehensive basis of accounting, in October 1996, the Under Secretary of Defense (Comptroller) issued the "DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity."

Reporting of Eliminating Entries

Eliminating entries generally were not reported or were not properly reported on the FY 1995 financial statements of the entities to be included in the FY 1996 DoD-wide Consolidated Financial Statements. Unreported interdepartmental transactions (between DoD Components) were calculated at \$74.5 billion in revenues, \$75.6 billion in collections, and \$10.2 billion in accounts receivable. The entities stated that they did not report eliminating entries because DoD accounting systems did not permit them to adequately identify the transactions and, except for DBOF, interdepartmental transactions did not affect the entities' financial statements. In prior audit reports, we identified similar conditions in DBOF for FYs 1992 through 1995 (see Appendix B). If such transactions are not reported and eliminated, DoD-wide and Government-wide consolidated financial statements will be materially overstated.

Transactions That Should be Eliminated

The most material and widespread types of transactions that should be eliminated from DoD financial statements are reimbursable sales and purchases (transactions between DoD Components and transactions within the same DoD appropriation, account, or entity). Reimbursable sales affect at least four general ledger accounts: revenues, unearned revenues, accounts receivable, and collections. Reimbursable purchases affect expenses, advances, accounts payable, and disbursements.² Eliminating entries should be made on consolidating financial statements, which include a column for each entity, a column for eliminating entries, and a total column.

The amounts in the general ledger accounts must equal the data in the monthly "Report on Reimbursements," accounting report (M)725, prepared by the Defense Finance and Accounting Service (DFAS) centers. This report gives budget execution data on reimbursements by sources and appropriations. For each fiscal year of an appropriation, the DFAS centers prepare a "Report on

²Although not shown after FY 1995, collections and disbursements are netted (offset) within the line item "Fund Balance With Treasury" on the statement of financial position. Therefore, failure to eliminate such reimbursable transactions does not necessarily result in misstatement of the financial statements.

Reimbursements" by source categories that include intrafund, other Defense, and other non-Defense. The report includes amounts for reimbursements earned, collected, and receivable for each source category.

Guidance on Eliminating Entries

DoD has provided specific guidance on how to report eliminating entries. However, no guidance exists on how to identify transactions that should be eliminated.

OMB Guidance. The OMB Bulletin No. 94-01, which was effective through FY 1996, does not address eliminating entries. However, OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, requires agencies to show consolidated financial statements adjusted for intra-entity eliminations starting in FY 1996.

DoD Guidance for FYs 1994 and 1995. The "DoD Guidance on Form and Content of Financial Statements for FY 1994 and 1995 Financial Activity," October 1994, expanded the reporting requirements of OMB Bulletin No. 94-01 to include Note 29, "Intrafund Eliminations." The DoD guidance states:

Program managers are reminded that Note 29 includes interdepartmental sales between DoD components. If interdepartmental sales exist for a reporting activity but are not captured by the accounting system, then such inability of the accounting system to capture material amounts of transactions must be disclosed.

Intrafund and Interdepartmental Transactions. Intrafund transactions pertain to sales within the same appropriation, account, or reporting entity. For example, intrafund transactions within the Army General Fund would include sales from the Procurement of Ammunition account to the Operation and Maintenance account. Interdepartmental transactions pertain to sales between DoD Components. An example would be sales from the Air Force General Fund to the Navy General Fund or from the Army business areas of DBOF to the Army General Fund.

Use of Schedules in Note 29. The DoD guidance for FYs 1994 and 1995 directs the entity to disclose in Note 29 any intrafund or interdepartmental sale transactions in three possible schedules: Schedule A, intrafund transactions excluding DBOF; Schedule B, intrafund transactions within DBOF; and Schedule C, interdepartmental transactions.

Reporting of Eliminating Entries

Schedule A. The DoD guidance states that general ledger amounts should be entered for accounts receivable, revenues, unearned revenues, and collections. The guidance also assumes that equal amounts of accounts payable, expenses, advances, and disbursements have been entered on the accounting records of the purchasing activities, and that consequently, those amounts should be eliminated from the component's principal statements.

Schedule C. The DoD guidance requires the selling DoD Components to report sales to the buying DoD Components so that the latter can footnote in their principal statements equal amounts of accounts payable, expenses, advances, and disbursements.

DoD Guidance for FY 1996. The "DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity," October 1996, assumes that, for all reimbursable transactions within DoD, the buying activity has entered accounts payable, expenses, advances, and disbursements equal to the selling activity's accounts receivable, revenues, unearned revenues, and collections. However, the DoD guidance for FY 1996 does not require the selling DoD Component to identify sales to the buying DoD Component.

Intragovernmental Eliminations. Neither OMB Bulletin No. 94-01 nor the DoD guidance for FYs 1994 and 1995 addresses intragovernmental eliminations. However, the DoD guidance for FY 1996 expands the requirements of Note 29 to include this category in FY 1996.

Government-wide Guidance. The Eliminations Entries Subgroup of the Government-wide Audited Financial Statements Task Force (the task force) was also developing guidance on identifying and reporting eliminating entries. Because the subgroup's draft issue paper recognized that a Government-wide systems solution may require a significant amount of time and resources for agencies to implement, the issue paper would have allowed agencies to use interim solutions as necessary until a permanent solution could be implemented. However, the task force has been replaced by the Accounting and Audit Policy Committee. The task force's issue papers will form the foundation of the Accounting and Audit Policy Committee's work.

Applicability of Eliminating Entries

Eliminating entries did not apply to all DoD reporting entities in FY 1995. Specifically, they did not apply to the financial statements of the Corps of Engineers or the National Defense Stockpile Transaction Fund. However, disclosure of eliminating entries will apply to those entities in FY 1996 because they received reimbursements from other Federal agencies.

Disclosure in Financial Statements

Eliminating entries generally were not reported or were not properly reported on the FY 1995 financial statements of the entities to be included in the FY 1996 DoD-wide Consolidated Financial Statements. Table 1 shows the amounts earned, collected, and receivable from reimbursable sales that the entities reported in Note 29. The Army and the Air Force were the only entities that reported any amounts. Sales to other Federal agencies were not reported; existing guidance did not require such sales to be reported.

Table 1. Reported Reimbursable Sales for FY 1995
(Billions)

Entity	Interdepartmental Sales			Intrafund Sales		
	Earned	Collected	Receivable	Earned	Collected	Receivable
Army	\$4.92	\$4.78	\$0.72	\$5.28	\$5.25	\$0.76
Air Force	0.00	0.00	0.00	2.52	0.00	0.74
Total	\$4.92	\$4.78	\$0.72	\$7.80	\$5.25	\$1.50

Army. The Army General Fund financial statements for FY 1995, prepared by the DFAS Indianapolis Center, disclosed eliminating entries in Note 29 by using all three schedules prescribed by the DoD guidance for FYs 1994 and 1995. However, \$0.62 billion in sales from the Army to DBOF was misclassified as intrafund within DBOF (Schedule B) rather than interdepartmental (Schedule C). Such misclassification can cause improper elimination from an entity's principal statements, resulting in an understatement of accounts, rather than proper elimination from consolidated statements. In Table 1, we reclassified those sales as interdepartmental. Also, within Schedule C, the account balances for the Navy and the Air Force were reversed. This reversal would cause erroneous amounts to be reported to customers for footnoting of accounts payable, expenses, advances, and disbursements in their principal statements.

Navy. The Navy General Fund Consolidated Financial Statements for FY 1995, prepared by the DFAS Cleveland Center, did not disclose any eliminations. However, these are mock financial statements; the Navy was not required to prepare financial statements for FY 1995.

Reporting of Eliminating Entries

Air Force. The Air Force General Fund financial statements for FY 1995, prepared by the DFAS Denver Center, disclosed intrafund eliminations (Schedule A) but not interdepartmental eliminations (Schedule C) in Note 29. The DFAS Denver Center did not include interdepartmental eliminations because sales to other DoD entities did not affect the Air Force statements.

Defense Business Operations Fund. The DBOF Consolidated Financial Statements for FY 1995, prepared by the DFAS Indianapolis Center, did not disclose any eliminations. Note 1.F. stated:

Inter/intra-agency transactions and balances have, for the most part, not been eliminated in the Principal and Combining Statements because data elements resident in the DoD accounting systems have not been revised to identify those transactions within a Department 97 (DoD) account. Sufficient detail information is not available in the standard DoD general ledger accounts to perform the elimination. No eliminations are reflected in the Combining Statements.

U.S. Army Corps of Engineers. The Corps of Engineers financial statements for FY 1995 did not disclose eliminations. However, the Corps of Engineers had significant intragovernmental transactions with the Environmental Protection Agency, the Department of Energy, the Department of State, the National Aeronautics and Space Administration, the U.S. Information Agency, and the Federal Emergency Management Agency. For example, in FY 1995, the Corps of Engineers charged more than \$575 million to the Environmental Protection Agency for work on the Superfund. Although neither OMB Bulletin No. 94-01 nor DoD guidance for FYs 1994 and 1995 required entities to report intragovernmental transactions in FY 1995, the information is required in FY 1996.

Other Reporting Entities. The financial statements of the DoD Military Retirement Trust Fund and the National Defense Stockpile Transaction Fund stated that Note 29 was not applicable to their respective funds. We agree that Note 29 did not apply to those entities in FY 1995.

Reportable Reimbursable Sales

We used the "Report on Reimbursements" dated September 30, 1995, to calculate the amounts of reportable reimbursable sales for five of the eight reporting entities. No "Report on Reimbursements" was prepared for the Corps of Engineers, the DoD Military Retirement Trust Fund, or the National Defense Stockpile Transaction Fund.

Table 2 shows that the reportable amounts earned, collected, and receivable from reimbursable sales were material. For example, the total reportable interdepartmental sales earned, \$79.5 billion, was over 16 times greater than the \$4.9 billion actually reported (Table 1). Also, DBOF alone represented \$63.1 billion (79 percent) of the reportable \$79.5 billion in reimbursable sales earned. Although Other Defense Organizations was not a separate reporting entity in FY 1995, amounts for this group are included to show the anticipated effect in FY 1996.

Table 2. Reportable Reimbursable Sales for FY 1995
(Billions)

Entity	Interdepartmental Sales			Intrafund Sales		
	Earned	Collected	Receiv- able	Earned	Collected	Receiv- able
Army	\$ 4.80	\$ 4.75	\$ 0.73	\$2.25	\$2.29	\$0.35
Navy	3.22	2.96	2.81	1.14	1.04	0.54
Air Force	3.40	3.30	1.06	1.34	0.98	0.50
DBOF	63.11	64.48	5.45	2.49	2.51	0.03
Other	<u>4.93</u>	<u>4.92</u>	<u>0.88</u>	<u>0.09</u>	<u>0.09</u>	<u>0.12</u>
Total	\$79.46	\$80.41	\$10.93	\$7.31	\$6.91	\$1.53

For transactions from other Federal agencies, we calculated earnings at \$2.6 billion, collections at \$2.5 billion, and receivables at \$2.1 billion. We did not include these amounts in Table 2 because they were not reportable in FY 1995.

Unreported Reimbursable Sales

We determined the amounts of unreported reimbursable sales by calculating the differences between reported and reportable reimbursable sales (Tables 1 and 2) for the five entities reviewed. Table 3 shows that the unreported amounts earned, collected, and receivable from reimbursable sales were substantially greater than the amounts actually reported in FY 1995. For example, the \$74.5 billion in unreported interdepartmental sales earned was 94 percent of the \$79.5 billion in reportable interdepartmental sales earned (Table 2). Also, DBOF represented \$63.1 billion (85 percent) of the \$74.5 billion in unreported

Reporting of Eliminating Entries

sales earned. The negative amounts in Table 3 resulted because the Army and the Air Force reported greater amounts, particularly for intrafund sales, than we calculated from the "Report on Reimbursements."

Table 3. Unreported Reimbursable Sales for FY 1995
(Billions)

Entity	Interdepartmental Sales			Intrafund Sales		
	Earned	Collected	Receiv- able	Earned	Collected	Receiv- able
Army	(\$ 0.12)	(\$ 0.03)	\$ 0.00	(\$3.03)	(\$2.97)	(\$0.41)
Navy	3.22	2.96	2.81	1.14	1.04	0.54
Air Force	3.40	3.30	1.06	(1.18)	0.99	(0.24)
DBOF	63.11	64.48	5.45	2.49	2.51	0.03
Other	4.93	4.92	0.89	0.09	0.09	0.12
Total	\$74.54	\$75.63	\$10.21	(\$0.49)	\$1.66	\$0.03

Failure to report and eliminate such transactions will result in material overstatements of assets, liabilities, revenues, and expenses on these entities' principal and DoD-wide consolidated financial statements starting in FY 1996 and on Government-wide consolidated statements starting in FY 1997.

Identification of Transactions

Management stated that DoD accounting systems did not permit them to adequately identify eliminating entries. We found the following limitations in current DoD systems.

For sales transactions, general ledger systems can only distinguish between Federal and non-Federal customers. Budgetary systems, which use reimbursable source codes, must be used to identify specific customers. Also, current coding structures do not contain sufficient detail to identify customers below department level. The insufficient detail would not allow correction of unreconciled balances even if coding structures identified sellers. Further, current coding structures cannot always identify intragovernmental customers. This limitation will prevent entities from providing complete disclosure in the DoD-wide Consolidated Financial Statements for FY 1996 and the Government-wide Consolidated Financial Statements for FY 1997.

For purchase transactions, current coding structures do not identify sellers. Therefore, sales and purchases cannot be reconciled with each other. Because of this limitation, the DoD guidance for FYs 1994 and 1995 requires that selling components identify sales to buying components for footnoting of equal amounts of accounts payable, expenses, advances, and disbursements in each component's principal statements. However, based on our review of Note 29, the reporting entities did not mutually identify sales in FY 1995. Further, the FY 1996 DoD guidance has deleted this requirement.

Army and Other Defense Organizations. The DFAS Indianapolis Center is responsible for identifying and reporting eliminating entries for the Army and Other Defense Organizations.

Army. For the Army, the DFAS Indianapolis Center identified intrafund and interdepartmental elimination transactions for Note 29, and prepared the "Report on Reimbursements" by using a computer retrieval program that extracted sales data from the Army's Departmental Budgetary Accounting and Reporting System.

Other Defense Organizations. For Other Defense Organizations, the DFAS Indianapolis Center prepared only the "Report on Reimbursements." The DFAS Indianapolis Center did not prepare Note 29 because Other Defense Organizations was not a reporting entity in FY 1995. However, the DFAS Indianapolis Center should prepare Note 29 and perform the eliminations for Other Defense Organizations in FY 1996.

Air Force. The DFAS Denver Center identified only intrafund sales transactions for Note 29 by extracting data from the Air Force's Departmental On-Line Accounting and Reporting System. The system can identify most interdepartmental sales to other DoD entities and a few intragovernmental customers, but the DFAS Denver Center had no computer program to retrieve this data. Although the DFAS Denver Center produces the "Report on Reimbursements," the DFAS Denver Center did not use the report to identify sales elimination data because the report did not list customers.

Defense Business Operations Fund. The DBOF Consolidated Financial Statements for FY 1995 did not disclose eliminations because of systems limitations. However, we obtained summary information from the "Report on Reimbursements." Although the reports did not identify specific customers, they summarized revenues, collections, and receivables from intrafund, other Defense, and other non-Defense sources that could have been used to perform the eliminations on the DBOF Consolidated Financial Statements for FY 1995. Also, the IG, DoD, audit report on Defense Logistics Agency (DLA) revenue eliminations within DBOF showed that information was available in sufficient detail to use in performing the eliminations (see Appendix B).

Reporting of Eliminating Entries

DoD Guidance. Both the DoD guidance for FYs 1994 and 1995 and the DoD guidance for FY 1996 recognize the limitations in current DoD accounting systems and attempt to compensate for them. Both sets of guidance provide reporting instructions for eliminating entries as sales transactions and assume that the purchasing activity has entered equal amounts in corresponding accounts. The DoD guidance for FY 1996 requires that eliminating entries reported in financial statements must be reconciled to the "Report on Reimbursements." The DoD guidance for FY 1996 also notes that many current systems do not collect data on specific appropriations and that DoD is developing procedures to identify and collect these data on a DoD-wide basis. However, the FY 1996 DoD guidance deletes the requirement that the selling DoD Component identify sales to the buying DoD Component.

Conclusion

Eliminating entries can and should be identified for a more accurate presentation of entity and consolidated statements. Although data available in the DoD standard general ledger accounts may not be sufficiently detailed to use in performing eliminations, data from budgetary systems can be used to identify the sales.

Current DoD accounting systems do not permit eliminating entries to be fully identified. General ledger systems can only identify sales transactions of Federal and non-Federal customers. Budgetary systems, which contain reimbursable source codes, allow better identification of eliminating entries, but are still inadequate. Current coding structures do not identify sellers for purchase transactions, do not contain sufficient detail to identify customers below department level, and cannot always identify intragovernmental customers.

In its FY 1996 guidance, DoD recognizes the value of the "Report on Reimbursements" by requiring eliminating entries to be reconciled to the reports. The budgetary databases that support the "Report on Reimbursements" should be used to prepare Note 29 until general ledger accounting systems can provide the necessary information. Although the budgetary databases also have limitations, they provide a starting point for reporting eliminating entries.

Until requirements have been developed by the Accounting and Audit Policy Committee and the Under Secretary of Defense (Comptroller), extensive changes to current DoD systems to improve identification and reporting of eliminating entries are not appropriate. However, currently available information should be used, and additional capability should be built into interim migratory and future systems.

Recommendations and Management Comments

Revised, Redirected, and Renumbered Recommendations. As a result of management comments, we revised and redirected draft Recommendation 1.c. to the Under Secretary of Defense (Comptroller) to ensure that policy is issued to require that reimbursable sales transactions be identified and reported. Draft Recommendations 1.c. and 2. have been renumbered as Recommendations 2. and 3.

1. We recommend that the Director, Defense Finance and Accounting Service:

a. Establish requirements for new and interim migratory accounting systems that will identify sellers and purchasers in reimbursable transactions.

Management Comments. DFAS concurred with the recommendation, stating that a program management office has been established to develop standard DoD accounting systems. The program management office also plans to award a contract for the review and analysis of eliminating entry requirements for the new departmental reporting system currently in development. DFAS estimated that the review and analysis will be completed by October 1997.

b. Develop procedures for the Defense Finance and Accounting Service centers to extract reimbursable transactions from databases that currently support the "Report on Reimbursements," accounting report (M)725, and report this information in Note 29, "Intrafund Eliminations."

Management Comments. DFAS concurred with the recommendation, stating that DFAS will prepare guidance on the identification of eliminating entry amounts to be reported in DoD entities' financial statements, DoD-wide financial statements, and Government-wide financial statements. DFAS estimated that its guidance will be issued in July 1997, 1 month after DoD issues the "DoD Guidance on Form and Content of Financial Statements for FY 1997 Financial Activity."

2. We recommend that the Under Secretary of Defense (Comptroller) issue policy requiring that sellers and purchasers in reimbursable transactions be identified, and that selling DoD Components be required to report annual sales to purchasing DoD Components so that the purchasing DoD Components can list equal amounts of accounts payable, expenses, advances, and disbursements in Note 29 to their financial statements.

Reporting of Eliminating Entries

3. We recommend that the Commander, U.S. Army Corps of Engineers, establish procedures for identifying transactions with other Federal agencies and report this information in Note 29.

Management Comments. The Corps of Engineers concurred with the recommendation, stating that the present information system cannot retrieve the required data from district offices. Although the information system is being replaced with a financial management system capable of retrieving the data, the new system will not be fully deployed until FY 1999. In the interim, the Corps of Engineers will prepare Note 29 manually.

Audit Response

Management comments on draft Recommendations 1.a., 1.b., and 2. are responsive. As a result of management comments, we revised and redirected draft Recommendation 1.c. (now Recommendation 2.) to the Under Secretary of Defense (Comptroller) to ensure that policy is issued to require that reimbursable sales transactions be identified and reported. We request comments from the Under Secretary of Defense (Comptroller) by May 30, 1997.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

We conducted this financial audit from January through December 1996. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and accordingly included such tests of management controls as were considered necessary. We reviewed records and supporting documentation, dated from 1993 through 1996, concerning reimbursable transactions that should be eliminated from reporting entities' financial statements and DoD-wide consolidated financial statements. The entities' assets reported by DoD in FY 1995, excluding Other Defense Organizations, totaled \$1,306 billion, and revenues totaled \$303 billion. We examined the FY 1995 financial statements of the entities to be included in the FY 1996 DoD-wide Consolidated Financial Statements to determine whether eliminating entries were properly reported. Also, for those entities, we summarized intrafund, interdepartmental, and intragovernmental reimbursable transactions from the "Report on Reimbursements," accounting report (M)725, as of September 30, 1995. We also reviewed the process for identifying and reporting eliminations at the DFAS Indianapolis Center and the DFAS Denver Center. We did not evaluate the general and application controls of the DFAS systems that generated the "Report on Reimbursements," although we relied on the data to conduct the audit. We did not evaluate the controls because the amount of resources needed to audit the large number of systems that produce the reports was not justified. No projections were made from the data. Not evaluating the controls did not affect the results of the audit. The scope of the audit was limited in that we did not review the management control program.

Management Control Program

The results of our evaluation of management controls will be addressed in our report on internal controls for the FY 1996 DoD-wide Consolidated Financial Statements.

Organizations and Individuals Visited or Contacted

We visited or contacted individuals and organizations within the DoD. Further details are available on request.

Appendix B. Prior Audits and Other Reviews

Inspector General, Department of Defense. IG, DoD, Audit Report No. 96-198, "Defense Logistics Agency Revenue Eliminations," was issued on July 22, 1996. The report stated that revenues from DLA sales to customers within DBOF were not eliminated from the FY 1995 financial statements. Consequently, revenue of \$13.3 billion reported by DLA in the FY 1995 DBOF Consolidated Financial Statements was overstated by at least \$8.4 billion. Also, \$11 billion of the \$13.3 billion would need to be eliminated from DoD-wide consolidated financial statements. We recommended that the Director, DFAS, establish procedures to eliminate revenues from sales to intrafund customers when preparing DBOF financial statements. We also recommended that the Director, DFAS Columbus Center, identify and report to the DFAS Indianapolis Center those revenues to be eliminated when preparing the DoD-wide consolidated financial statements. Responding for the Director, DFAS Columbus Center, the Deputy Director for Business Funds, DFAS, concurred with the finding but proposed alternative action. The Deputy Director for Business Funds, DFAS, stated that the Office of the Deputy Chief Financial Officer, DoD, was working with the Eliminations Entries Subgroup of the Government-wide Audited Financial Statements Task Force to develop procedures to identify interfund and interagency transactions to be implemented in FY 1997. Also, the Office of the Deputy Chief Financial Officer was developing procedures to be included in the "DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity." The IG, DoD, considered the alternative action to be responsive to the recommendations.

IG, DoD, Audit Report No. 96-178, "Internal Controls and Compliance With Laws and Regulations for the Defense Business Operations Fund Consolidated Financial Statements for FY 1995," was issued on June 26, 1996. The report cited eliminating entries as 1 of 10 major internal control deficiencies. This determination was based on a finding in the DLA report (see Audit Report No. 96-198) and the Statement of Operations for Supply Management, Army DBOF. On that Statement of Operations, revenue and cost of goods sold were overstated by \$848 million because the DFAS Indianapolis Center eliminated intrafund sales transactions at net rather than gross. The Army Audit Agency recommended that the Director, DFAS Indianapolis Center, require the accounting offices to report gross sales, make intrafund eliminations, and footnote the financial statements. The Director, DFAS Indianapolis Center, concurred with the recommendations.

IG, DoD, Audit Report No. 95-294, "Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994," was issued on August 18,

1995. The report discussed inadequate accounting for intrafund transactions. In several situations, the mechanisms used to track and account for these transactions were nonexistent or only partially developed. Specifically:

- o the Navy DBOF Consolidating Financial Statements were overstated by at least \$3.2 billion for collections and \$1.4 billion for revenues because the amounts were not disclosed or eliminated;

- o the Army DBOF Financial Statements omitted transactions amounting to \$420 million between Army and non-Army activities;

- o the DLA had not separately identified DBOF intrafund transactions for any of its business areas; and

- o the DFAS Denver Center based its eliminating entry for intrafund accounts receivable and accounts payable on insufficient data.

The Under Secretary of Defense (Comptroller) concurred with the report.

IG, DoD, Audit Report No. 94-161, "Consolidated Statement of Financial Position of the Defense Business Operations Fund for FY 1993," was issued on June 30, 1994. The report stated that the notes to the financial statements did not include an explanation for the intrafund eliminations. Failure to record intrafund eliminations resulted in overstatements of assets, liabilities, and equity in the reporting entity's statement of financial position and the consolidated statement of financial position. No recommendations were made in the report; therefore, management comments were not required, and none were received.

IG, DoD, Audit Report No. 93-134, "Principal and Combining Financial Statements of the Defense Business Operations Fund - FY 1992," was issued on June 30, 1993. The report stated that there were no eliminating entries or disclosures on intrafund transactions. The report also stated:

Approximately \$17.7 billion of intrafund transactions among business areas of the DBOF are not properly identified or eliminated from the FY 1992 DBOF Combining or Consolidated financial statements. This is a result of the lack of specific DBOF controls and policies regarding the treatment of those transactions. In addition, the present accounting systems used to record disbursements and collections are not designed to identify and retain the intrafund data when both the buyer and seller are DBOF activities. Due to the lack of guidance and inadequate accounting systems, we were unable to determine what amount of intrafund transactions should have been eliminated or disclosed in the DBOF financial statements. The DoD Comptroller estimated \$17.7 billion in intrafund transactions for the DBOF during FY 1992.

Appendix B. Prior Audits and Other Reviews

The Under Secretary of Defense (Comptroller) concurred with the finding and responded that DBOF policy on intrafund transactions had not been issued. The Under Secretary of Defense (Comptroller) further stated that, until the policy is issued, changes to DoD accounting systems to identify and record intrafund transactions should not be made. As of November 1996, the policy had not been issued.

Naval Audit Service. Naval Audit Service Report No. 044-95, "FY 1994 Consolidating Financial Statements of the Navy Defense Business Operations Fund," was issued on May 30, 1995. The report stated:

The Department of the Navy did not include the required "Intrafund Eliminations" note in its Fiscal Year 1994 Department of the Navy Defense Business Operations Fund Consolidating Financial Statements. An intrafund transaction involves a sale between two Defense Business Operations Fund activities. Department of Defense guidance requires that such sales be captured so that the amounts can be eliminated from Department of Defense statements, since such transactions only involve funds moving from one Government activity to another. However, the Department of the Navy did not have procedures needed to collect data for the note. As a result, the Department of the Navy Defense Business Operations Fund Consolidating Financial Statements were overstated by at least \$3.2 billion for collections and \$1.4 billion for revenues. This could result in inaccurate information being presented to decision makers.

The Naval Audit Service recommended that the Director, DFAS, aggressively pursue and develop reporting procedures for intrafund eliminations in sufficient time for presentation on the FY 1995 financial statements. Management partially concurred, stating that DoD was developing techniques to eliminate intrafund transactions. However, management added that DoD did not have the capability to collect the required data throughout FY 1995 and was not likely to have it soon.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller) and Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Commander, U.S. Army Corps of Engineers
Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Defense Finance and Accounting Service Comments



DFAS-HQ/AFB

DEFENSE FINANCE AND ACCOUNTING SERVICE
1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

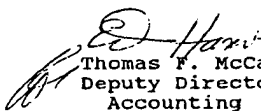
FEB 26 1997

MEMORANDUM FOR ACTING DIRECTOR, FINANCE AND ACCOUNTING
DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL,
DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on Eliminating Entries (Project No.
5FH-2026)

DFAS has reviewed the draft audit report findings and
recommendations. Attached are our comments and response to the
recommendations.

If you have any questions, my point of contact on this audit
is Mr. Thomas Tresslar, (703) 607-1120, or e-mail to
ttresslar@cleveland.dfas.mil.


Thomas F. McCarty
Deputy Director for
Accounting

Attachment

cc:
DFAS-HQ/PA
DFAS-HQ/DDP

DoDIG Draft Audit Report on Eliminating Entries
Project No. 5FH-2026

DFAS Management Comments:

1. DoD Progress in reporting Eliminating Entries:

DFAS has made progress in the reporting of Intrafund Eliminations footnote from FY 1995 to the current FY 1996 CFO reports. The elimination entries needed to prepare the DoD Consolidated statements were reported by Army, Navy, Air Force, and DBOF in Note 29, Schedule D. DFAS did not obtain eliminating entries for "Other Defense Organizations" but will address this issue for FY 1997 CFO statements. The elimination entries needed by Treasury to prepare Federal Government-wide statements are reported in Note 29, Schedule E by Army, Navy, Air Force, and DBOF.

2. No FASAB or OMB Eliminating Entry Guidance:

There is no FASAB standard, OMB, GAO, or Treasury policy guidance on eliminating entries. Treasury in the FACTS reporting only requires the identification and breakout on some accounts between Government and Non-Government.

3. Need DoD Audit and Comptroller Communities to raise the visibility of the eliminating entry issue.

The DoD Comptroller and Audit communities need to push for the completion of standard eliminating entry requirements by OMB, GAO, and Treasury. This is required to ensure the cost efficiency and operational effectiveness across the Federal Government on the identification and reporting of eliminating entries. It is essential that standard requirements be recommended in a timely manner by the Government-wide Financial Statements Task Force - Eliminating Entries working group and adopted by OMB, GAO, and Treasury to ensure standard requirements be implemented in Federal-wide accounting systems. Otherwise DoD and other Federal agencies will implement requirements to meet the current needs and then additional changes and costs may have to be incurred when standard eliminating entry requirements are finally issued at the FASAB, OMB, GAO, and Treasury level.

4. Current Reimbursable Source Code (RSC) Requirements.

DoD guidance requires seven RSCs. These seven source codes are not adequate to prepare all CFO statements and notes. However over the years, some DoD Components have developed procedures that expand the coding in various DoD accounting systems. This expanded coding allows for additional breakouts of the reimbursable transactions that can be used to improve the level of detail in the "Intrafund Eliminations" footnote.

DoDIG Draft Audit Report on Eliminating Entries
Project No. 5FH-2026

Recommendation 1.a. Establish requirements for new and interim migratory accounting systems that will identify sellers and purchasers in reimbursable transactions.

DFAS Response 1.a. Concur. The Defense Finance and Accounting Service has established a Program Management Office (PMO) to develop standard DoD accounting systems. The PMO plans to issue a contract for the review and analysis of eliminating entry requirements for the new departmental reporting system currently in development.

We strongly agree with the last paragraph of your Conclusion:

"Until requirements have been finalized by the Government-wide Audited Financial Statements Task Force and the Under Secretary of Defense (Comptroller), extensive changes to current DoD systems to improve identification and reporting of eliminating entries are not appropriate. However, currently available information should be used and additional capability built into interim migratory and future systems."

The estimated completion date for the PMO review and analysis of eliminating entry requirements is: **October 1997**

Recommendation 1.b. Develop procedures for the Defense Finance and Accounting Service centers to extract reimbursable transactions from databases that currently support the "Report on Reimbursements" accounting report (M) 725, and report this information in note 29, "Intrafund Elimination's."

DFAS Response 1.b. Concur. DFAS will prepare additional procedural guidance on the identification of eliminating entry amounts for use in the preparation of three levels of financial statements: 1) the Federal Government-Wide financial statements, 2) the DoD-Wide Consolidated financial statements, and 3) the DoD Entity level CFO statements that are audited and reported to OMB.

This information will also be used to prepare the "Intrafund Eliminations" footnote in DoD CFO reports. The level of detail required to complete some schedules in the "Intrafund Eliminations" footnote varies among DoD accounting systems. For those current accounting systems that the Reimbursable Source Code structure does not extend beyond the seven codes required by DoD, DFAS will not be able to fully implement this recommendation until the new DoD Budget Accounting Classification Code and new accounting systems are implemented.

The completion date for the additional guidance on eliminating entries is 1 month after the FY 1997 DoD Guidance on Form and Content is issued. Estimated Completion Date: **July 1997**

DoDIG Draft Audit Report on Eliminating Entries
Project No. 5FH-2026

Recommendation 1.c. Require the Defense Finance and Accounting Service centers to report total annual sales from selling DoD Components to each purchasing component so that the purchasing components can footnote in their principal statements equal amounts of accounts payable, expenses, advances, and disbursements.

DFAS Response 1.c. Nonconcur. Currently, there is no Office of Management and Budget nor DoD Comptroller guidance that requires this additional reporting requirement.

In addition, the proposed reporting requirements would add an unnecessary workload, expense, and would not be practical to implement given the short time frames allowed for the CFO reporting. "Sellers" would be forced to reconcile their accounting records with the accounting records of every "buyer" they conducted business with during the year.

Revised,
redirected,
and renum-
bered as
Recommen-
dation 2.

U.S. Army Corps of Engineers Comments



REPLY TO
ATTENTION OF:

DEPARTMENT OF THE ARMY
U.S. Army Corps of Engineers
WASHINGTON, D.C. 20314-1000

24 January 1997

CEAO (36-2[a, b, c])

MEMORANDUM THRU Office of the Assistant Secretary of the Army,
Financial Management and Comptroller, Attn:
SAFM-FOP, Mr. James Short

FOR Inspector General, Department of Defense, Attn: Mr. Jay
Layne, Acting Director, Finance and Accounting Directorate

SUBJECT: IG DoD Draft Report, Project No. 5FH-2026, Eliminating
Entries -- RESPONSE

Enclosed is the official command response to the draft report on
the subject audit.

FOR THE COMMANDER:

Encl
as

Otis Williams
OTIS WILLIAMS
Colonel, Corps of Engineers
Chief of Staff

U.S. Army Corps of Engineers Comments

Final Report
Reference

COMMENTS ON DRAFT AUDIT REPORT

Project No. 5FH-2026, Reporting of Eliminating Entries

Finding. The U.S. Army Corps of Engineers (Civil Works) (the Corps) financial statements for FY 1995 did not disclose eliminations. However, the Corps had significant intragovernmental transactions with the Environmental Protection Agency, the Department of Energy, the Department of State, the National Aeronautics and Space Administration, the U.S. Information Agency, and the Federal Emergency Management Agency. For example, in FY 1995, the Corps charged more than \$575 million to the Environmental Protection Agency for work on the Superfund. Although neither OMB Bulletin No. 94-01, DoD guidance for FYs 1994 and 1995, nor DoD guidance for FY 1996 requires entities to report intragovernmental transactions, the information is necessary for a fair presentation of FY 1997 Government-wide consolidated statements.

Additional Facts. None.

Recommendation for Corrective Action.

1. Recommendation 2: We Recommend that the Commander, U.S. Army Corps of Engineers (COE), establish procedures for identifying transactions with other Federal agencies and report this information in Note 29.

USACE Response: Concur. Currently we have no upward reporting mechanism in-place to retrieve this data from our district offices using the Corps of Engineers Management Information System (COEMIS). This system is currently being replaced with the Corps of Engineers Financial Management System (CEFMS) which already has a mechanism, called "Category Class Sub-class" or CCS codes (similar to our military reimbursable source codes), to satisfy this requirement. However, since the full deployment target date for CEFMS is not until 30 September 1998, we will have our COEMIS activities provide manual footnote No. 29 statements.

ENCLOSURE

Renumbered
as Recommendation 3.

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

F. Jay Lane
Raymond D. Kidd
Saundra G. Elion
Dennis E. Coldren
Donney J. Bibb
Sheela M. Javeri
Edwin L. Wilkinson
Susanne B. Allen

INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Eliminating Entries

B. DATE Report Downloaded From the Internet: 10/26/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ Preparation Date 10/26/99

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.